PHLX
PHILADELPHIA STOCK EXCHANGE

Memorandum No. 0025-08

Memorandum

To: DL-Memos, DL Post

From: Steve Pettibone, Vice President Options Reviews

Date: January 7, 2008

RE: Guidance for Delta Based Position Limits – LOPR Reporting, and Aggregation

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The Philadelphia Stock Exchange, Inc. ("Phlx" or "Exchange"), announces intention to file Delta Hedging amendments to PHLX Rules 1000 and 1001, and Issues Guidance Concerning Large Options Position Reports and Aggregation of Certain Positions.

Delta Hedging Rule Filing Excerpt - Aggregation of Accounts

"The proposed rule change would expand the general guidance in Phlx Rule 1001 regarding aggregation of certain options accounts. An entity relying on the proposed rule change would generally be required to ensure that a Permitted Pricing Model is applied to all positions in or relating to the security or securities underlying the relevant options position that are owned or controlled by the entity, or its affiliates. However, the net delta of an options position held by an entity entitled to rely on this Exemption, or by a separate and distinct trading unit of such entity, would be permitted to be calculated without regard to positions in or relating to the security or securities underlying the option held by an affiliated entity or by another trading unit within the same entity, provided that: (1) the entity demonstrates to Phlx's satisfaction that no control relationship, exists between such affiliates or trading units, and (2) the entity has provided Phlx written notice in advance that it intends to be considered separate and distinct from any affiliate, or, as applicable, which trading units within the entity are to be considered separate and distinct from each other for purposes of this Exemption."

Delta Hedging Rule Filing Excerpt - Position Reporting

"Today, per Phlx Rule 1003 (Reporting of Options Positions), a member and member organization must file a report with the Exchange with respect to each account in which they have an interest, each account of a partner, officer, director, or employee of such member organization, and each customer account, acting alone, or in concert with others, which has established an aggregate position of 200 or more options contracts (whether long or short) of the put class and the call class on the same side of the market, in the case of options on stock or Exchange-Traded Fund Shares. Under the proposed rule change, Phlx would retain these reporting thresholds even with respect to options positions of any member or designated aggregation unit that are delta neutral. In addition, however, each member or designated aggregation unit pursuant to subparagraph (d) of proposed Rule 1001 Commentary .09, also shall report the options equivalent of the net delta of a position if such position represents 200 or more contracts (whether long or short) on the same side of the market covering the same underlying stock that are effected by the member. Referring to the example above, a member who is short 20,000 call contracts with a delta of .5 and long 600,000 shares of stock and long 200,000 shares through a SWAP or futures contact, would report (a) its options position as short 20,000 contracts and (b) its options equivalent of the net delta as short 2,000 contracts.

The Exchange understands that in addition to Phlx, NASD and other self-regulatory organizations ("SROs") are working on modifying the Large Options Position Reporting ("LOPR") system and/or the OCC reports to allow a member to indicate that an equity options position is being delta hedged."

Guidance - Large Options Position Reports

PHLX Rule 1003 (a) requires members to file, or cause to be filed, reports for each account that has an aggregate position of 200 or more of options contracts (whether long or short) on the same side of the market covering the same underlying security or index. These reports are referred to as LOPRs (Large Options Position Reports). As a result of enhancements to the Securities Industry Automation Corporation's (SIAC) LOPR system, PHLX eliminated manual reporting of LOPRs for conventional options in July of 2005. Today, LOPRs for both standardized and conventional options are filed electronically.

LOPRs subject to the reporting requirements of Rule 1003 (a) should be transmitted to SIAC no later than the close of business on the next day following the day on which the transaction or transactions requiring the filing of such report occurred. In addition, PHLX Rule 1001 requires each member to promptly report to PHLX any instance in which the member has reason to believe that a person, acting alone or in concert with others, has exceeded or is attempting to exceed the applicable exercise limits or position limits.

Applicability of LOPR Requirements

PHLX reminds members that its options position reporting requirements apply to "access" firms with respect to positions in standardized options, and all firms with respect to positions in conventional options, except for certain conventional index options as discussed below. In addition, firms availing themselves of the use of one of the equity option hedge exemptions must report the hedge instrument positions.

PHLX also is reiterating its prior guidance that Rule 1001 does not apply to certain types of options, including:

- Options in respect to which the writer is the issuer of the security which may be purchased or sold upon the exercise of the option; and

- Warrants issued by a large, publicly held U.S. company on the common stock of a non-U.S. company in which the U.S. company has a 20% ownership interest.

Guidance - Position Limit Aggregation Requirements

Separately, PHLX is announcing guidance regarding position limit aggregation requirements. PHLX reminds members of their obligation under PHLX Rule 1001 Commentary .01 to aggregate the reports of all accounts under common control or those acting in concert for purposes of determining the proper position limit. "Control" is defined as "the power or ability of an individual or entity to make investment decisions for an account or accounts, or influence directly or indirectly the investment decisions of any person or entity who makes investment decisions for an account." Control is presumed to exist in the following circumstances:

- among all parties to a joint account who have authority to act on behalf of the account;

➢ among all general partners to a partnership account;

➢ when a person or entity holds an ownership interest of 10 percent or more in an entity or shares in 10 percent or more of profits and/or losses of an account;

➢ when accounts have common directors or management; or

➢ where a person or entity has the authority to execute transactions in an account.

In addition, PHLX will consider the following factors in determining whether aggregation of accounts is required:

➢ similar patterns of trading activity among separate entities;

➢ the sharing of kindred business purposes and interests;

➢ Whether there is common supervision of the entities which extends beyond assuring adherence to each entity's investment objectives and/or restrictions; and

➢ the degree of contact and communication between directors and/or managers of separate accounts.

However, the control presumed by one or more of the above powers, abilities or circumstances can be rebutted by proving that a particular factor does not exist or by showing other factors which negate the presumption of control. PHLX consideration of whether requests of certain accounts are not required to be aggregated will be handled on a case-by-case basis, and any guidance indicating that accounts need not be aggregated will not be retroactive. Proof of any rebuttal of otherwise presumed control must be submitted to PHLX by affidavit and/or such other evidence as may be appropriate in the circumstances. Firms should submit such requests to the Options Reviews Department, to the attention of Position Limit Analyst, at fax number (215) 496-5567.

Affiliated Broker-Dealers or Trading Units

When analyzing requests for non-aggregation treatment between affiliated broker-dealers or separate and distinct trading units within the same broker-dealer, PHLX will require a brokerdealer(s) to satisfy the following conditions:

➢ operate the trading unit(s) requesting non-aggregation treatment independently of other trading units controlled by the broker-dealer, and disclose to PHLX the trading objective of the trading unit(s) requesting non-aggregation treatment;

➢ create internal firewalls and information barriers to segregate the trading unit(s) receiving non-aggregation treatment from other trading units controlled by the broker-dealer to prevent the flow of information (*e.g.*, trades, positions, trading strategies);

➢ conduct all trading activity of the trading unit(s) requesting non-aggregation in a segregated account, which shall be reported to PHLX as such;

➢ maintain regulatory compliance oversight and internal controls and procedures addressing the non-aggregation arrangement;

➢ retain written records of information concerning the non-aggregated account, including, but not limited to, trading personnel, names of personnel making trading decisions, unusual trading activities, disciplinary action resulting from a breach of the broker-dealer's systems firewalls and information-sharing policies, and the transfer of securities between the broker-dealer's non-aggregated accounts, which information shall be promptly made available to PHLX upon its request;

➢ promptly provide to PHLX a written report at such time there is any material change with respect to the non-aggregated account, which PHLX will use as a basis to reexamine its determination of non-aggregation; and

➢ provide a written acknowledgement that PHLX reserves the right to (1) impose additional restrictions and conditions with respect to the granting and removal of non-aggregation, and (2) freeze any position above the applicable position limit if PHLX determines that aggregation has become necessary due to changed circumstances.

Generally, the presumption of control in these types of arrangements will become easier to rebut as the physical separation between the trading units increases. For example, PHLX will require that trading units located on the same floor of a building be physically isolated from each other to ensure that no inappropriate communication will take place between individuals staffed in the applicable trading units.